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SUPREME COURT OF THE UNITED STATES

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OCTOBER TERM, 1922.

HERMAN G. GERDES, as trustee in bankruptcy of ABRAHAM LUSTGARTEN, Bankrupt,
Petitioner,

—VS.—

ABRAHAM LUSTGARTEN,
Respondent.

PETITION FOR WRIT OF CERTIORARI, BRIEF AND NOTICE OF APPLICATION.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1922.

HERMAN G. GERDES, as trustee in bankruptcy of ABRAHAM LUSTGARTEN, Bankrupt,
Petitioner,

—vs.—

ABRAHAM LUSTGARTEN,
Respondent.

TO THE HONORABLE, THE CHIEF JUSTICES AND ASSOCIATED JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petition of HERMAN G. GERDES, trustee in bankruptcy of Abraham Lustgarten, bankrupt, filed pursuant to provision 25-D of the Bankruptcy Act of 1898, respectfully represents:

FIRST. An involuntary petition in bankruptcy was filed against Abraham Lustgarten, the bankrupt herein, on the 1st day of March, 1921, and an adjudication followed on the 4th day of April, 1921. The bankrupt applied for a discharge and certain creditors entered appearances and duly filed specifications of grounds of their opposition to the bankrupt's petition for discharge. Pursuant to an order made by the referee in bankruptcy, petitioner was duly authorized to prosecute

the objections to bankrupt's petition for discharge upon the specifications filed by creditors.

SECOND. Four grounds of opposition were specified, to-wit: (1) that with intent to conceal his financial condition, the bankrupt had destroyed, concealed or failed to keep books of account or records, from which such condition might be ascertained; (2) that he had obtained money or property on credit upon material false statement in writing made by him to a person or his representative for the purpose of obtaining credit from such person; (3) that he had subsequent to the first day of the four months immediately preceding the filing of the petition transferred, removed or sold, or permitted to be transferred, removed or sold, $2,000 of his property, with intent to hinder, delay or defraud his creditors; (4) that he had committed offenses punishable by imprisonment as provided in the Acts of Congress relating to Bankruptcy, and that he knowingly made a false oath in the bankruptcy proceedings (Rec. pp. 6 to 11).

THIRD. On January 5, 1920, the bankrupt delivered to the Corn Exchange Bank a financial statement reflecting his condition as of December 15, 1919, which financial statement showed the bankrupt to have a net worth on December 15, 1919 of $58,135.89. It was proven by the bankrupt's books of account that on December 15, 1919 his net worth was $23,158.43 indicating that the financial statement was inflated to the extent of $32,388.46 (Rec. fols. 116, 117).

This financial statement contained the following:

> "This statement is to be regarded by Abraham Lustgarten and by the Corn Exhange

> Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, and other matters to be relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement shall be substituted for this or this statement recalled * * * and further whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change whether applications for further loans are made or not" (Rec. pp. 104, 106).

The Corn Exchange Bank extended credit to the bankrupt upon the filing of this statement on October 29, 1920, November 4, 1920 and February 11, 1921, no notice having been received by the Bank of any change in the financial condition of the bankrupt and the statement not having been recalled.

FOURTH. The bankrupt paid to one Louis Lustgarten, a nephew, the sum of $2,000 within three months prior to the bankruptcy (Rec. fols. 306, 308). No entries appear in the bankrupt's books showing any indebtedness to Louis Lustgarten (Rec. fols. 111, 113). The bankrupt testified that said nephew was employed in the bankrupt's business during the year 1919 at a salary of $50 and in 1920, at a salary of $60, and that the bankrupt deducted $20 each week from said nephew's salary and held same as savings for him. In December, 1920, the nephew requested payment of his savings and $2,000 was paid to him (Rec. fols. 306, 308). The only entry in the books of the bankrupt is an entry of payment as follows: December 8th,

$1,000; December 22nd, $1,000, which entries appear in the cash book and also appear to be posted to a book of accounts with salesmen (fols. 111, 113). Nothing appears in the books as credit to offset these debits (fol. 113). The Special Master held that the Corn Exchange Bank had no right to rely upon the statement in extending credit after a period of ten months had elapsed from the date of the statement (Rec. fol. 6); and the Special Master also found in favor of the bankrupt upon the facts with respect to the specifications of fraudulent concealment of $2,000 from the trustee in bankruptcy and failure to keep proper books of account. The District Court reversed the Special Master and sustained the specifications as to the false financial statement and as to the failure to keep proper books of account (Rec. fols. 321, 323). The Circuit Court of Appeals reversed the District Court and sustained the Special Master.

FIFTH. The Circuit Court of Appeals held, following its earlier decision, in re *B. & R. Glove Co.*, 279 Fed. Rep. 372, that the bank had no right to rely upon the financial statement because of the lapse of nearly ten months between the date of the statement and the extension of credit. The Circuit Court of Appeals also held that the failure to note the obligation of the bankrupt to his nephew was due to inadvertent, faulty bookkeeping, and not to any intent to conceal his financial condition, and that the trustee failed to adduce proof that the bankrupt's failure to enter the credits due his nephew was with intent to conceal his financial condition.

SIXTH. Your petitioner seeks to have this Court determine the following questions:

(1) Whether a bankrupt who issues a financial statement containing a provision that the same may be relied upon by the creditor until another statement shall be substituted, and a further provision to the effect that he will advise of any change in his financial condition, may obtain his discharge if he gave no notice of a change of his condition and gave no other statement, if the creditor relied upon the statement, and if such financial statement proves to be false not only at the time when the statement was acted upon but that it was originally false when made;

(2) Whether the omission by a bankrupt to enter in his books a debt due a relative, which debt was paid within three months prior to the bankruptcy, is a failure to keep proper books of account within the meaning of Section 14-B, Subd. 2 of the Bankruptcy Act.

SEVENTH. Your petitioner assigns the following reasons for the allowance of the writ:

(a) The questions presented are of general importance to the commercial world because one question involves the measure of reliance which banks and merchants may place upon a financial statement issued for the purpose of obtaining credit; and the other, whether a bankrupt may with impunity fail to enter in his books of account debts due to relatives.

(b) It is important that this Court pass upon both questions because the holding of the Circuit Court of Appeals renders a bankrupt immune to the penalty prescribed by the Bankruptcy Act for the giving of a false finan-

cial statement, unless a merchant before extending credit obtains a new statement every few months, notwithstanding the express agreement of the bankrupt that the creditor may rely upon the statement until notified of a change; and because the ruling of the Circuit Court of Appeals may encourage the fraudulent practice on the part of some bankrupts to pay moneys to relatives and friends upon fictitious debts, unless such bankrupts are held to strict accountability for failure to enter such obligations in books of account.

(c) The decision in this case with respect to the false financial statement is contrary to the decision of the Circuit Court of Appeals in the Fifth Circuit, *In re Regan vs. Cotton,* 200 Fed. Rep. 546, and the decision of the Circuit Court of Appeals in the Third Circuit, *Haimowich vs. Mandel,* 243 Fed. Rep. 338.

WHEREFORE, your petitioner prays that this Honorable Court will grant a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, commanding the said Court to certify and send to this Court a transcript of the record and all proceedings of said Circuit Court of Appeals in this case, therein entitled "In the Matter of *Abraham Lustgarten,* bankrupt-appellant," to the end that this case may be reviewed and determined by this Court, as provided by law, and the judgment and order of said Circuit Court of Appeals may be reversed by this Honorable Court.

HERMAN G. GERDES,
as Trustee in Bankruptcy,
Petitioner.

CITY, COUNTY AND STATE OF NEW YORK, ss.:

HERMAN G. GERDES, being duly sworn, deposes and says that he is the petitioner herein; that he has read the foregoing petition and that the allegations thereof are true as he verily believes.

HERMAN G. GERDES.

Subscribed and sworn to before me, this
19th day of May, 1923.

LEWIS H. SAPER,
Notary Public, Kings County,
Kings County Clerk's No. 164,
Kings County Register's No. 4187,
N. Y. County Clerk's No. 482,
N. Y. County Register's No. 4487.
Commission expires March 30, 1924.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

STATEMENT OF FACTS.

The facts are set forth in the petition annexed but it is desired to supplement the same by the following:

The financial statement referred to contained the following figures:

ASSETS.

Merchandise	$39,004.97
Accounts Receivable	30,642.50
Cash in Bank	9,042.79
Cash on hand	945.63
Fixtures & Machinery	1,500.00
Total	$81,135.89

LIABILITIES.

For Merchandise	$3,000.00
For Bank Accommodation	20,000.00
Total	$23,000.00
Net Surplus	$58,135.89

(Exhibit 1 of March 17, 1922, Rec. pp. 104-105.)

The items claimed to be falsified were "Merchandise $39,004.97" and "Accounts Receivable $30,642.50." The falsity of these items were proved by comparison with the bankrupt's books of account (Rec. fols. 116-117). The books showed the bankrupt's merchandise to be $24,721.17 (fol. 116) and

accounts receivable to be $9,053.25 (fol. 117). The bankrupt attempted to explain this discrepancy as follows:

The inventory of $24,721.17, shown on the bankrupt's books, consisted of woolen piece goods; that due to the faulty method of bookkeeping, this inventory failed to include linings, silks, satins, velvets and manufactured goods, coats, suits, dresses and capes, and also failed to include paper-boxes, wrapping paper, twines, trimmings, stationery and printing, and that although the books showed an inventory of only $24,721.17, as a matter of fact the bankrupt did have merchandise which inventoried at $39,004.97 the amount shown in the financial statement.

Likewise the discrepancy in the outstanding accounts is explained by faulty bookkeeping due to the failure of the bookkeeper to enter upon the books upon closing, items of merchandise outstanding with salesmen, merchandise outstanding with customers shipped on approval and merchandise shipped customers and not entered in the books, the sales having been made a day or two before the closing of the books and of which sales memoranda were entered upon slips of paper on the bookkeeper's desk and not carried into the books (fols. 171-178).

The Special Master not having passed upon the questions of fact with respect to the falsity of the financial statement, the only purpose in directing attention to the bankrupts is in connection with the specification of the failure to keep proper books of account.

POINT I.

THE DECISION OF THE LEARNED CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH THE DECISION IN RE RAGAN, MALONE & CO. vs. COTTON & PRESTON et al., CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT, 200 Fed. Rep. 545; AND HAIMOWICH vs. MANDEL, CIRCUIT COURT OF APPEALS, THIRD CIRCUIT, 243 Fed. Rep. 338.

In re Ragan, Malone & Co. vs. Cotton & Preston, et al. (*supra*), the financial statement contained the following clause:

> "This statement shall be binding for each purchase now or hereafter made unless changed by written authority from the undersigned."

The statement is dated August 5, 1907. Credit was obtained from time to time up to March 6, 1908.

We quote from the opinion of Pardee, C.J., at page 550:

> "There is considerable discussion in the briefs as to the effect, legal and moral, of the declaration in the first paragraph of the statement made by Preston, to wit:
>
> > 'This statement shall be binding for each purchase now or hereafter made, unless changed by written authority from the undersigned.'
>
> And it is argued that, as the bankrupts before adjudication had paid for the first purchase of goods obtained under the statement, Ragan, Malone & Co. had no right to rely upon it as a basis of credit for any subsequent pur-

chase. The account of Ragan, Malone & Co. with the bankrupts appears to be a running account, covering purchases from time to time for a little over one year, on which the credits made at no time left the account fully paid up, so that it is only an assumption, depending upon the correct imputation of payments, to say that the first purchase was ever fully paid for. But, be that as it may, *the parties agreed that the statement should be binding for continuous credit. The evidence is that it was relied upon by the creditors in the subsequent credits, as well as in the first, and we know of no reason to go behind the agreement.*" (Italics are ours.)

In re Haimowich vs. Mandel (*supra*), the financial statement was issued in March, 1912, to the Mercantile Agency of R. G. Dun & C. In September, 1912, the creditor received from Dun & Co. the bankrupt's statement and sold merchandise relying upon it.

We quote from the opinion of Wooley, C.J., at 342:

"the test of whether a false statement given upon one date and communicated and acted upon on a later date operates as a bar to a discharge, is two-fold: (1) Whether the agency was the representative of the prospective creditor at the time the statement was communicated to and acted upon by him; and (2) whether at that time the false statement was still in force and binding upon the bankrupt, to be determined according as it is found that the sale on credit was or was not the proximate result of the statement (In re Braverman (D.

C.) 199 Fed. 863, 28 Am. Bankr. Rep. 513), and that its original falsity was or was not the thing that worked the mischief."

In re Levenson, 223 Fed. Rep. 874 (District Court of Massachusetts), a false financial statement was given containing a provision that it should be considered continuing in force until the creditor was notified to the contrary. The financial statement was dated December 12, 1911, as of December 4, 1911, various credits were extended, the last being on July 12, 1912. The Court sustained the objections to confirmation of composition.

POINT II.

THE FACTS IN THE CASE OF B. & R. GLOVE CORPORATION, 279 Fed. Rep. 372, WHICH THE CIRCUIT COURT OF APPEALS FOLLOWED IN THIS CASE ARE DIFFERENT THAN THE FACTS IN THIS CASE.

In B. & R. Glove Corporation (*supra*), the financial statement contained the following provision:

> "The undersigned also expressly agrees to notify the Irving National Bank of any material reduction of financial responsibility of the undersigned."

The provision in the financial statement in the instant case is as follows:

> "This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, and other matters to be

relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement shall be substituted for this or this statement recalled * * * and further whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change whether applications for further loans are made or not" (Rec. pp. 104, 106).

The test applied by the Court *In re Haimowich vs. Mandel* is the test which should have been applied in this case, namely, whether "the original falsity was or was not the thing that worked the mischief."

From the record folios 128-129, it appears that upon giving the statement in question, the bankrupt established a line of credit to the extent of $15,000, which was fixed by the Board of Directors of the creditor bank. It was the original statement which gave the bankrupt his credit standing with the bank to the extent of $15,000.

The District Court properly applied this test:

"Thus, the questions are of fact, and are, did the creditor actually rely on the financial statement, and, under the circumstances shown, did he have a right so to rely.

In my judgment, if a man gives to a Bank from whom he regularly borrows, a statement which contains (as the commissioner finds this one did) that it was a continuing statement and that the borrowee would notify the Bank at once of any material changes in his exhibited financial condition,—upon such a statement, the Bank has a right to rely until such

notice is given. That is the very bargain between the borrower and lender" (Rec. fols. 320-321).

POINT III.

THE LEARNED CIRCUIT COURT OF APPEALS ERRED IN REVERSING THE FINDING OF THE DISTRICT COURT THAT THERE WAS A FAILURE TO KEEP PROPER BOOKS.

In re Hanna, 168 Fed. Rep. 238, the Circuit Court of Appeals, Second Circuit, it was said:

> "A provision intended to insure the keeping of correct and complete accounts should be rigidly enforced, especially one whose operation is made to depend upon intention, excluding mistake or neglect."

In re Koelle, 22 A. B. R. 515, the District Court, Eastern District of Pennsylvania, held:

> "Where a bankrupt's indebtedness amounted to $21,000, of which $8,000 was due to merchandise creditors whose names appeared upon his books, and the balance was due to his wife, relatives and various friends for loans, and the only explanation he gave why none of their names appeared on his books was that he knew the lenders would not push him and that he thought it was not necessary for his creditors to know that he had money from his wife, he will be denied his discharge on the ground that, with intent to conceal his financial condition, he failed to keep books of account or records from which such condition might be ascertained."

The District Court held:

> "The bankrupt maintains that he really owed shortly before his failure $2,000 to his nephew, who had been in his employment.
>
> Such a debt was by no means trifling considering the extent of this bankrupt's business and his available assets. The existence of the debt made a material difference in his net assets.
>
> No trace of the debt is found in his books and the intent necessary by the statute is one of reasonable inferences" (fols. 321, 322).

We advert to the fact that the bankrupt issued a false statement which he attempted to explain by failure to make proper entries in his books of account. It is inconceivable that the books should have erred to the extent of $32,388.46. From the entire record in this case, the District Court was justified in drawing the inference of intent, for no other inference could be drawn from a failure to enter a debt which was accruing through a period of two years prior to bankruptcy.

Respectfully submitted,

MOSES COHEN,
Attorney for Petitioner.

NOTICE.

SIR:

PLEASE TAKE NOTICE, that the annexed petition and brief, and a copy of the record in this cause, will be submitted to the Supreme Court of the United States, in its Court Room, at the Capitol in the City of Washington, D. C., on the 4th day of June, 1923, at the opening of Court on that day.

Dated, N. Y., May 19, 1923.

Yours, &c.,

MOSES COHEN,
Attorney for Petitioner,
No. 49 Chambers Street,
New York City.

To:
LAURENCE J. BERSHAD, ESQ.,
Attorney for Respondent,
No. 291 Broadway,
N. Y. City.

The foregoing notice is hereby accepted, and delivery of a copy thereof and of the foregoing petition and brief is hereby acknowledged.

LAURENCE J. BERSHAD,
Attorney for Abraham Lustgarten,
Respondent.